

Retirement Plan Options for American Expats

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As with most financial planning issues for Americans living abroad, retirement planning options can be more limited and more complex than they are when living in the U.S. In most cases, the familiar U.S. employer-sponsored retirement plans like 401(k)s are not available to expats. Foreign employers cannot offer them since they are required to be set up in the U.S., and most U.S. employers don't offer them, primarily because the company uses a foreign business entity for tax purposes.

Often, foreign employers will offer their own local, private pension plan, which may or may not be advantageous to the U.S.-connected employee. Employer contributions or a matching component could be beneficial, unless the investments in the plan are considered PFICs (Passive Foreign Investments Companies), in which case the punitive tax and considerable reporting obligations may outweigh the perceived benefits.

What options does that leave to the American living overseas and trying to save for retirement? IRAs, SEP IRAs and Solo 401(k)s for the self-employed, U.S. brokerage accounts, and on a limited basis, tax-deferred annuities, can all prove to be useful tools for American expats to save for retirement. I'll discuss IRAs, SEP IRAs, and Solo 401(k)s here.

IRAs – Contributions to either Traditional or Roth (if under the income limits) are available to overseas Americans. Unfortunately, while contributing to an IRA is usually a viable retirement savings option for most American expats, the annual contribution limits are relatively low at \$6,000 a year (\$7,000 if age 50 or over).

Many Americans think that they cannot continue to contribute to an IRA once they move outside of the U.S., but they can if they have unexcluded earned income. To be clear, it does not matter if it is foreign-sourced or U.S.-sourced income, just that it is unexcluded and earned.

For Americans with foreign-sourced income, who file their U.S. taxes using the Foreign Earned Income Exclusion (FEIE), this means that they either need to earn more than the FEIE cap (\$108,700 for 2021, \$112,000 for 2022), to have eligible unexcluded income to use for IRA contribution purposes, or they need to limit the amount that they exclude to allow for the amount that they want to contribute to an IRA.

If the earned income is U.S.-sourced, then the FEIE would not apply, and they can contribute to an IRA. In either case, foreign-sourced or U.S.-sourced income, the U.S.-connected person could contribute to a Traditional IRA regardless of income, or to a Roth IRA if they meet the normal Roth income phase out limits <https://www.irs.gov/retirement-plans/plan-participant-employee/amount-of-roth-ira-contributions-that-you-can-make-for-2022>

It should be noted that if planning on retiring overseas, the U.S.-connected person should consult a qualified international tax advisor to see if the bilateral tax treaty between the U.S. and the country in which they plan to retire recognizes the tax-free withdrawal properties of Roth accounts. Most countries do not.

SEP IRA or Solo 401(k) – For self-employed individuals, the Simplified Employee Pension (SEP) IRA or Solo 401(k) have annual contribution limits that mirror regular employer sponsored retirement plan

limits equal to \$61,000 in 2022 (\$67,500 if age 50 or over). The calculation for the actual allowable contribution amounts is based on either 25% of self-employment income, or based on 25% of the net earnings for the firm. SEP contributions all come from the employer, and if the firm has more than one employee, the employer must make the same percentage contribution to all eligible employees' accounts.

Contributions for Solo 401(k)s have both an employee elective deferral component, as well as an employer contribution component. The employee elective deferral can be 100% of the employee's earnings up to \$20,500 in 2022 (without the age 50+ catchup provision), while the employer contribution is a percentage of total compensation up to \$40,500. <https://www.irs.gov/retirement-plans/one-participant-401k-plans>

Solo 401(k)s allow for contributions on a Roth basis, while SEP IRAs do not. Solo 401(k)s can only be established for an U.S.-based entity, while a SEP can be established based on earnings from a foreign-registered firm, as well as for U.S.-based companies or earnings.

It is important to consult with a qualified international tax advisor when setting up the self-employed retirement accounts while overseas, as the tax benefits, and strategic decision regarding filing requirements will differ depending on the country of residence. For example, when living in a higher tax country than the U.S., there will be no immediate benefit of a tax deduction for contribution to a SEP when filing U.S. taxes, so contributions are made on an after-tax basis. One strategy would be to file the appropriate IRS form to demonstrate the after-tax character of the contributions, and at a later time convert to a Roth account, without having to pay the tax on the contributions during conversion.

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